INDEX

	Page
Petition:	
Question presented	1
Statute and regulations involved	2
Statement	2
Specification of errors to be urged	4
Reasons for granting the writ	5
Brief in support of petition:	
Opinions below	7
Jurisdiction	7
Question presented, statute involved, etc	7
Argument	8
Conclusion	13
Appendix	15

CITATIONS

Cases:	
Comar Oil Co. v. *Burnet*, 64 F. (2d) 965, certiorari denied, 290 U.S. 652	6, 11, 12
Darby-Lynde Co. v. *Alexander*, 51 F. (2d) 56, certiorari denied, 284 U.S. 666	5, 6, 11, 13
Ginsberg & Sons v. *Popkin*, 285 U.S. 204	12
Helvering v. *Falk*, 291 U.S. 183	10
Helvering v. *New York Trust Co.*, No. 873, decided May 28, 1934	6, 12, 13
Night Hawk Leasing Co. v. *Burnet*, 57 F. (2d) 612	9
Palmer v. *Bender*, 287 U.S. 551	5, 10
Rockford Life Insurance Co. v. *Helvering*, No. 722, decided May 21, 1934	6, 13
Statutes:	
Revenue Act of 1926, c. 27, 44 Stat. 9:	
Sec. 204 (U.S.C. App., title 26, sec. 935)	15
Sec. 213 (U.S.C. App., title 26, sec. 954)	15
Sec. 214 (U.S.C. App., title 26, sec. 955)	16
Sec. 233 (U.S.C. App., title 26, sec. 985)	16
Sec. 234 (U.S.C. App., title 26, sec. 986)	17
Revenue Act of 1932, c. 209, 47 Stat. 169, sec. 114	13
Miscellaneous:	
H. Conference Rep. No. 1492, 72d Cong., 1st sess., p. 14	13
H. Rep. No. 356, 69th Cong., 1st Sess., pp. 31–32	9
S. Rep. No. 52, 69th Cong., 1st Sess., pp. 17–18	9
Treasury Regulations 69: Art. 221	17

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

TWIN BELL OIL SYNDICATE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit entered in the above entitled cause on April 12, 1934, reversing the decision of the Board of Tax Appeals in part.

QUESTION PRESENTED

Whether the depletion allowance to which a lessee's assignee is entitled under Section 204 (c) (2) of the Revenue Act of 1926 is 27½ percent of

the gross income from the leased wells excluding or not excluding amounts paid by it as rents and royalties.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 15–18.

STATEMENT

The facts as found by the Board and as stipulated (in part) by the parties are as follows:

The taxpayer is a California syndicate organized in 1922 for the purpose of acquiring a certain oil and gas lease and operating it. (R. 36–41.) Both the Board and the court below have held that the syndicate is to be treated as a corporation for Federal income-tax purposes.

The original lessee of the properties was one F. A. Andrews, who secured a twenty-year lease from the owner, W. O. Batson, in December, 1921. In addition to certain monthly rentals to be paid until drilling should commence the lessee agreed to pay as rental or royalty for the land "one-sixth (1/6) of all oil produced and saved therefrom, said payment to be made in money or in kind at the Lessor's option." (R. 86–90.)

On February 10, 1922, Andrews assigned all of his right, title and interest in the lease to Thomas H. Lipps, who agreed to perform all of the covenants of Andrews and that in addition to the one-sixth royalty agreed to be paid to the lessors, he

would pay to Andrews "one-twelfth (1/12) of all petroleum, oil, gas and other oil products, and casing-head gasoline, produced and saved from each and all wells" on the property either in cash or in kind. (R. 95–97.)

On April 25, 1922, Lipps assigned all his right, title and interest in the lease to the trustees of the syndicate, who agreed to comply with all of the terms and conditions of the original lease and also of the assignment by Andrews. (R. 103–105.)

The one-sixth royalty and the one-twelfth royalty paid to Andrews during the taxable years 1925, 1926 and 1927 were as follows (R. 18):

Year	Batson Royalties	Andrews Royalties
1925	$159,853.20	$79,926.60
1926	143,253.02	71,626.51
1927	70,946.34	35,473.17

In the audit of the taxpayer's returns for 1925, 1926 and 1927, the Commissioner held that the above-mentioned royalties should be deducted from the gross income from the wells before computing the 27½ percent deduction for depletion allowed under Section 204 (c) (2). (R. 18–19.) The Commissioner determined deficiencies as the result of this and other adjustments, and the taxpayer appealed to the Board.

The Board sustained the Commissioner's allowance for depletion, but decided against the Commissioner on another issue. Both parties appealed.

The Circuit Court of Appeals for the Ninth Circuit reversed the Board on the issue concerning depletion, which was one of two issues in the syndicate's appeal. That court held that the 27½ percent deduction should be computed on the gross income of the syndicate without deduction for the rents and royalties. The other issues involved in the case were decided for the Government and are not here involved.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the term "gross income from the property" as used in Section 204 (c) (2) of the Revenue Act of 1926, *infra,* means gross income of the taxpayer as defined in Section 213 (a) of that Act, *infra.*

2. In holding that Section 204 (c) (2) should be construed independently of Section 234 (a) (8).

3. In holding that in the case of an assignee's lessee paying rents and royalties to his assignee and the lessor the term "gross income from the property" in Section 204 (c) (2) means gross income including such rents and royalties.

4. In failing to hold that the "gross income from the property" in which the percentage deduction for depletion is based under Section 204 (c) (2) means gross income less rents and royalties.

REASONS FOR GRANTING THE WRIT

1. We believe that the case conflicts in principle with the decision in *Darby-Lynde Co.* v. *Alexander,* 51 F. (2d) 56 (C.C.A. 10th), certiorari denied, 284 U.S. 666. In this case the court held that the term "gross income from the property" meant the gross income of the taxpayer as defined in Section 213. In the *Darby-Lynde* case, the court rejected that construction of Section 204 (c) (2), holding that the term "gross income from the property" meant gross income from production and did not include proceeds from the sale of the oil properties themselves, notwithstanding the fact that such proceeds constitute gross income. To this extent the two decisions are in conflict. Moreover, if the construction of the statute by the court below is correct and the taxpayer may take depletion based on the total gross income from the property including the rents and royalties, the depletion allowance of the taxpayer, lessor and assignor combined will be based on an amount in excess of the gross income from production. It is clear that the lessor and the assignor have an economic interest in the property within the meaning of *Palmer* v. *Bender,* 287 U.S. 551, and as they are entitled to one-fourth of the gross income from production, they would be allowed to base their deduction on that one-fourth, so that the allowance of all would be based on five-fourths of the gross income from production,

which is contrary to the decision in the *Darby-Lynde* case, *supra.*

2. Independently of a conflict, we believe that the result just mentioned is one never intended by Congress. In so far as that result has been reached by a literal construction of subdivision (2) of Section 204 (c) divorced from subdivision 204 (c) as a whole and from Section 234 (a) (8), which is the general provision granting allowances for depletion to corporations (Section 204 (c) merely providing the basis of the computation), the court below has ignored the cardinal rule recently reaffirmed by this Court that a statute must be construed as a whole and in such a way as to carry out the intention of Congress. *Helvering* v. *New York Trust Co.,* No. 873, October Term, 1933, decided May 28, 1934; *Rockford Life Insurance Co.* v. *Helvering,* No. 722, October Term, 1933, decided May 21, 1934.

The question involved here has not been decided by the case of *Comar Oil Co.* v. *Burnet,* 64 F. (2d) 965 (C.C.A. 8th), certiorari denied, 290 U.S. 652, upon which the court below relied. That case arose under the Revenue Act of 1921, which contained no provisions analogous to Section 204 (c) (2) of the Revenue Act of 1926, and the question involved was whether royalties received by an assignee of a lessee out of first oil produced and paid over to his assignor as consideration for the lease should be included in the assignee's gross income and if so, whether the payments could be deducted as business expenses.

3. The question of the proper construction of this provision in the Revenue Act of 1926 and of the same provision in the Revenue Act of 1928, is one of general importance. The Bureau of Internal Revenue states that refund claims based on an interpretation of the statute similar to that made by the court below now reach approximately $10,000,000.

Wherefore, it is respectfully submitted that this petition should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

JULY 1934.

BRIEF IN SUPPORT OF PETITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 14–27) is reported in 26 B.T.A. 172. The opinion of the Circuit Court of Appeals is reported in 70 F. (2d) 402.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 12, 1934. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED, STATUTE INVOLVED, ETC.

A statement of the question presented, statute involved, specification of errors to be urged, and a

statement of the case will be found in the foregoing petition.

ARGUMENT

Section 234 (a) (8) of the Revenue Act of 1926, *infra,* provides for the deduction of a reasonable allowance for depletion to corporations and provides that in the case of a lease the deduction shall be equitably apportioned between the lessor and the lessee. Section 214 (a) (9), *infra,* grants an allowance under similar conditions to individuals.

Section 204 (c) *infra,* provides that the basis on which depletion is to be allowed is the same as that provided in the case of a sale with certain exceptions. One of these exceptions is set forth in subdivision (2) as follows:

> In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

We submit that the authority for the deduction for depletion by corporations is contained only in Section 234 (a) (8), that Section 204 (c) merely provides the basis for the allowance and subdivision (2) merely provides that a percentage of the gross income shall constitute the basis in the case

of oil and gas wells, provided (1) that an allowance so computed is not less than that otherwise computed and (2) does not exceed 50 percent of the net income of the taxpayer computed without the benefit of the depletion deduction.

We submit that this analysis of the depletion provisions shows clearly that Section 204 (c) (2) is to be construed in conjunction with Section 234 (a) (8) which authorizes the deduction and that when so construed the provision for equitable apportionment between lessor and lessee is applicable whether depletion is based on cost or fair market value as of March 1, 1913, or is based on a percentage of gross income.

The legislative history of Section 204 (c) (2) does not disclose any intention on the part of Congress to do away with the requirement of apportionment between lessor and lessee in the case of the percentage deduction. The provision was inserted merely to put an end to the difficulties occasioned by the computation of depletion on the basis of discovery value in the case of oil and gas wells. S.Rep. No. 52, 69th Cong., 1st Sess., pp. 17–18; H.Rep. No. 356, 69th Cong., 1st Sess., pp. 31–32.

Hence, Section 204 (c) (2) must be construed in the light of the mandate of Section 234 (a) (8) that depletion must be equitably apportioned between lessor and lessee. *Night Hawk Leasing Co.* v. *Burnet,* 57 F. (2d) 612 (App.D.C.).

In the present case the taxpayer was the sublessee and operator of the property. It received the total income from the sale of oil and gas but was obligated to pay the lessor one-sixth and its assignee one-twelfth, a total of three-twelfths or one-fourth.

The Commissioner and the Board solved the problem of apportionment in the present case by holding that the phrase 27½ percent of the "gross income from the property" as employed in Section 204 (c) (2) meant the gross income from production less the amounts which the taxpayer was obliged to pay to his assignee and the lessee (i.e., one-fourth of the total). In that way the taxpayer would be allowed 27½ percent of the gross income from production which it was permitted to retain and his assignee and the lessor together would receive an allowance based on 27½ percent of the remaining one-fourth. Obviously, the lessor and the taxpayer's assignee have an economic interest in the property and are entitled to a deduction for depletion. *Palmer* v. *Bender,* 287 U.S. 551; *Helvering* v. *Falk,* 291 U.S. 183. But under the construction of the statute by the court below the taxpayer, the lessor and the assignee together would be allowed a deduction equal to 27½ percent of five-fourths of the gross income from the property.

It is unreasonable to suppose that Congress intended that a multiplication of interests in the property should result in a greater allowance for

depletion than the owner himself would be allowed if he operated the property. It is far more reasonable to assume that Congress intended that the percentage deduction allowable to all having an economic interest should amount in the aggregate to 27½ percent of the gross income from the property; that is, from production. There is no apportionment on any other theory.

It may be conceded that the portion of the income from the property which the taxpayer pays over to its assignee and the lessor is required to be reported in its gross income in its tax return (*Comar Oil Co.* v. *Burnet,* 64 F. (2d) 965 (C.C.A. 8th), certiorari denied, 290 U.S. 652), but the court below incorrectly assumed that the term "gross income from the property" means the taxpayer's gross income as defined in Section 213. See *Darby-Lynde Co.* v. *Alexander,* 51 F. (2d) 56 (C.C.A. 10th), certiorari denied, 284 U.S. 666.

In the *Darby-Lynde Company* case, the taxpayer argued that the proceeds from the sales of the oil property itself (in addition to proceeds of sales of oil and gas) constituted gross income and should be included in the gross income on which the percentage deduction was based. But the court rejected that argument, holding that the term "gross income from the property" as employed in Section 204 (c) (2) meant gross income from production.

Thus, the decision of the court below holding that "gross income from the property" means gross in-

come as defined in Section 213 conflicts in principle with that decision.

The decision in *Comar Oil Co.* v. *Burnet, supra,* is not opposed to our view in this case. It did not involve any question of depletion and arose under the Revenue Act of 1921 which contained no provision analogous to Section 204 (c) (2). The court merely held that amounts which an assignee received out of the first oil and gas produced and paid over to its assignee and the lessor constituted gross income and that they could not be deducted as business expenses, since they represented the cost of acquiring a capital asset.

The court below reached a result opposed to what we believe to be the clear intent of Congress by construing Section 204 (c) (2) independently of Section 234 (a) (8), when the two can only be intelligently construed together. It thus violated a cardinal rule of construction that a statute is to be construed as a whole so as to give a reasonable effect to all of its provisions. *Ginsberg & Sons* v. *Popkin,* 285 U.S. 204, 208; *Helvering* v. *New York Trust Co.,* No. 873, October Term, 1933, decided May 28, 1934.

We submit that the construction for which we contend is not inconsistent with the express language employed in Section 204 (c) (2). But even if a literal construction would compel the interpretation made by the court below, it should not be followed when to do so makes it impossible to give

effect to the probable intent of Congress as expressed in the statute as a whole. *Helvering* v. *New York Trust Co., supra; Rockford Life Insurance Co.* v. *Helvering,* No. 722, October Term, 1933, decided May 21, 1934.

The court below treated as significant the fact that in enacting Section 114 (b) (3) of the Revenue Act of 1932, which is analogous to Section 204 (c) (2) of the Revenue Act of 1926, here involved, Congress qualified the term "gross income from the property" by the clause "excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property" and thus adopted the construction for which we are contending. But the committee report relating to this change (see H. Conference Rep. 1492, 72d Cong., 1st Sess., p. 14) states that the amendment "makes it clear" that the exclusion is to be made. This explanation is susceptible of the view that Congress was merely enacting into law the correct interpretation of the existing law. See *Helvering* v. *New York Trust Co., supra.*

CONCLUSION

We submit that the decision of the Circuit Court of Appeals is incorrect, that it conflicts in principle with the decision of the Circuit Court of Appeals for the Tenth Circuit in *Darby-Lynde Co.* v. *Alexander, supra,* that the question involved is one of

general importance, and that the petition for a writ of certiorari should be granted.

Respectfully submitted.

J. CRAWFORD BIGGS,
Solicitor General.
FRANK J. WIDEMAN,
Assistant Attorney General.
JAMES W. MORRIS,
HELEN R. CARLOSS,
Special Assistants to the Attorney General.

JULY 1934.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 204. (c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph. (U.S.C.App., Title 26, Sec. 935.)

SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions,

vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period. (U.S.C.App., Title 26, Sec. 954.)

SEC. 214. (a) In computing net income there shall be allowed as deductions:

* * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee. (U.S.C.App., Title 26, Sec. 955.)

SEC. 233. (a) In the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross in-

come as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance. (U.S.C. App., Title 26, Sec. 985.)

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * *

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee. (U.S.C.App., Title 26, Sec. 986.)

Treasury Regulations 69:

ART. 221. *Depletion in the case of oil and gas wells.*—Under section 204 (c) (2), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property.

In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or its value at the basic date, as the case may be. In general, "the property," as the term is used in section 204 (c) (2) and this article, refers to the separate tracts or leases of the taxpayer.

U. S. GOVERNMENT PRINTING OFFICE: 1934